

**Original citation:**

Pirie, Iain. (2016) Korea and Taiwan : the crisis of investment-led growth and the end of the developmental state. Journal of Contemporary Asia.

**Permanent WRAP URL:**

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*<http://www.tandfonline.com/10.1080/00472336.2017.1375136> "*

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# **KOREA AND TAIWAN: THE CRISIS OF INVESTMENT-LED GROWTH AND THE END OF THE DEVELOPMENTAL STATE**

**Iain Pirie**

Department of Politics, University of Warwick, Coventry, CV4 7AL, United Kingdom

**Email:** I.J.Pirie@warwick.ac.uk

**Abstract:** A defining feature of the Northeast Asian developmental state was a focus on maximising investment and suppressing growth in consumption. While consistently high rates of investment were an integral part of the growth model, as the South Korean and Taiwanese economies matured, the viability of this model was undermined by the inability of these economies to generate sufficient opportunities for profitable investment. At the same time, the legacies of systems of labour control associated with the developmental state have impeded the development of stable wage-led growth regimes in both political economies. Instead, they have become reliant on an unstable combination of current account surpluses and consumer borrowing to sustain growth. The legacies of the developmental state continue to define many aspects of the political-economic landscape in Korea and Taiwan. However, changes in the growth regimes, the reorientation of the financial sectors from corporate to household lending, and the downgrading of industrial policy mean that it is no longer useful to define Korea or Taiwan as developmental states. Instead, contemporary Korea and Taiwan can be best understood as post-developmental states.

**Key words:** Developmental State, Consumer Debt, Export Dependency, Wages, Neo-liberalism, Post-developmental State

This article is concerned with changes in the role that investment has played in the political economies of South Korean and Taiwanese over the last three decades.

Changes in their aggregate levels of investment have attracted no real attention outside of the economics profession. However, it is our contention that declines in the rate of investment in both political economies have played a major role in undermining the systems of industrial planning associated with the developmental state (DS) and have fundamentally altered the basic function of the financial system. In short, the decline in rates of investment has played a key role in shaping broader processes of economic and social change in both states. Equally, an understanding of the changing role that investment has come to play in the Korean and Taiwanese growth models is vital to understanding the economic vulnerabilities both states now

face. Changes in rates of investment are not primarily a product of financial liberalisation. Rather, they reflect the increasing inability of both economies to generate sufficient opportunities for profitable investment to absorb domestic saving.

The contribution of this paper is both critical and constructive. A focus on rates of investment does not negate the key arguments advanced by critical scholars on the rise of neo-liberalism in Northeast Asia and how neo-liberalism has been shaped by the legacies of the authoritarian developmental state (Tsai, 2001; Minns, 2006; Doucette, 2010; Chang, 2012). Nor does it take away from an analysis of how global geo-political and economic change has destabilised the developmental state (Tsai, 2001; Gills, 2000; Grey, 2011). However, it can add another dimension to this analysis. It is impossible to fully understand the growth of household debt in Korea and Taiwan or these economies' increasing dependence on external surpluses without analysing changes in rates of investment. The links between rising household debt, falling rates of investment and dependency on export surpluses are clear. Aggregate demand is the sum of domestic demand for consumption and capital goods plus or minus net exports. If rates of investment fall dramatically it follows logically that without increases in consumption and/or net exports this will have a major negative impact on levels of aggregate demand. In any modern economy the majority of consumers receive most of their income in the form of wages. However, in Korea and Taiwan we have seen the simultaneous suppression of wages and falls in levels of investment. Domestic consumers are not in a position to increase consumption without reducing net saving. The fall in investment together with the decline in the wages share of national income made it inevitable that Korea and Taiwan would become increasingly dependent on household debt and external surpluses to sustain aggregate demand.

More critically the article seeks to directly challenge the literature that stresses the resilience of these developmental states. If we analyse key texts on how the Northeast Asian developmental state functioned historically written from both state-institutionalist and Marxist perspectives, we see agreement that the project involved major societal transformation. Furthermore, both approaches have stressed the importance of suppressing consumption and maximising investment. Writing from a state-institutionalist perspective, Kohli (2004) and Walder (1999) have argued that a successful developmental state requires the political marginalisation of the working class to ensure that a focus on capital accumulation is not compromised by demands for increased consumption. Both Marxist and critical statist scholars see the developmental state project as involving a traumatic effort to raise investment levels and transform social structures (Hart-Landsberg, 1993; Kohli, 2004; Minns, 2006; Chang, 2009). The literature that seeks to define contemporary Korea and Taiwan as developmental, on the other hand, takes relatively small-scale industrial promotion programmes involving limited resources as evidence of the resilience of developmental state structures (Weiss, 2003; Wong, 2005; Chu, 2007; Kim 2012; Thurbon, 2016). These definitions are inconsistent and by continuing to define Korea and Taiwan as developmental states this literature masks the scale of the changes that have taken place in both countries, particularly in terms of the role that investment plays in the growth regimes. Contemporary Korea and Taiwan cannot be understood as developmental states. That said, it remains important to understand how contemporary neo-liberal projects in both states continue to be shaped by the legacies of the developmental state. As will be shown, the concept of the post-developmental state is useful in helping us better understand the particular features of these political economies.

In order to advance the arguments regarding the importance of changes in levels of investment and the shift from the developmental to the post-developmental state, this article is divided into four sections. In the first section, we seek to develop relatively coherent definitions of the developmental, neo-liberal and post-developmental states. The second section focuses on changes that have taken place in the Taiwanese political economy since the 1980s. The third section is focused on the evolution of the Korean political economy over the same period. The final section analyses how the negative social impact of neo-liberal reform and the problems associated with transitioning to consumption-led growth have been exacerbated by the legacies of the developmental state. The arguments regarding the social impact of neo-liberal reform in post-developmental states are not new (see Doucette, 2010; Chang, 2012). However, the arguments advanced here regarding how the underdevelopment of welfare systems and the weakness of labour organisations have impaired the transition to a new sustainable growth regime are more original.

## **THE DEVELOPMENTAL, NEO-LIBERAL AND POST-DEVELOPMENTAL STATES**

Any assessment of the resilience of the developmental state in Korea and Taiwan and the extent to which these economies have engaged in neo-liberal reform must define what it means by neo-liberal and developmental. Furthermore, if we employ the concept of the post-developmental state we must seek to define it. It is to these tasks we now turn.

### **The developmental state**

Fine (2013: ) argues that the “developmental state paradigm” divides into economic and political schools. The political school is primarily concerned with questions relating to state capacity and how particular forms of state-society relationship promote or retard industrial development. The economic school is more focused on identifying the policies that promote rapid growth. Perhaps the most influential writer within the political school is Evans (1995), who defines the developmental state by its bureaucratic capacity and embedded autonomy. To function as an effective agent of development the state is seen to require a certain level of bureaucratic capacity and coherence. The state must simultaneously maintain a close working relationship with capitalists and a capacity to discipline capital. The state must, therefore, be both embedded and autonomous. Evans argues that developmental projects may be more sustainable in the long-term if the state maintains close relations with multiple social groups. Nevertheless, Evans acknowledges the exclusion of groups other than capitalists from governing alliances in actually existing developmental states. Other scholars working in the statist tradition have explicitly argued that the exclusion of other social groups (such as labour, small farmers) is an integral part of the developmental state project (see Waldner, 1999; Kohli, 2004).

Embedded autonomy is a necessary but not sufficient condition for effective developmental institutions. It is possible to identify state institutions that maintain a form of embedded autonomy and aggressively pursue neo-liberal policies. For example, the Bank of England has maintained a close relationship with key domestic financial institutions in its role as guarantor of financial stability since the 19<sup>th</sup> century. It is clearly “embedded.” Nevertheless, in the 1980s it pursued a policy of aggressively removing restrictions on competition that it was fully aware would lead to the bankruptcy of an array of domestic firms and ensure the domination of key

markets by overseas firms (Moran 1991: 55-87). The central bank sacrificed the interests of individual capitalists to its strategic objective of maintaining London as a global financial centre. In so doing, it demonstrated its autonomy. However, to the best of our knowledge the Bank of England has never been considered a developmental institution. We would argue that this is because the Bank simply acted to promote, or perhaps even create, global market disciplines. At least implicitly for the developmental state paradigm, to be considered developmental, an institution must intervene in the economy to achieve an allocation of resources that deregulated markets are unlikely to ever effect.

In this context Johnson (1983) and Woo (1991) both discuss the importance of cheap state-mediated credit in promoting the development of key industries in Japan and Korea respectively. Evans (1995) writes extensively of the importance of the state's "midwifery" role in directing capital to nascent industries it believed to possess long-term growth potential. As Fine (2013) recognises, the depth of policy analysis within the political school is quite limited. However, it is not true to say that this school ignores policy questions. Equally, there is extensive cross-referencing between the political and economic schools. The differences in these schools' approaches represents a division of labour, with one focusing on institutions and the other policy, rather than an intellectual disagreement.

The two most influential texts on the Northeast development state authored by economists are perhaps Amsden's (1989) *Asia Next Giant* on Korea and Wade's (1990) *Governing the Market* on Taiwan. Amsden (1989) sets out how the Korean state used its control of the financial sector to direct capital to industries with high long-term growth potential but with relatively low profitability. The state, not price signals, determined the direction of investment. At the same time, Amsden (1989:

118) highlights Korea's successes in achieving "one of the highest rates of investment in the world." Gross investment in Korea increased from 10.4% of GDP in 1960 to 35.8% of GDP during the heavy industrialisation drive in the 1970s (Chung 2007: 45).

According to Wade state control of finance was somewhat less important in determining investment flows in Taiwan than Korea. However, between 1951-1980 the public sector accounted for more than 30% of gross capital formation (Wade 1990: 177). The state used the *chaebol* to lead the development of strategic industries. The Taiwanese state used publicly owned firms. Partially as a result of investment by state owned firms rates of investment in Taiwan were "among the highest in the world over an extended period" (Wade 1990: 47). Gross domestic investment in Taiwan increased from 13.6% of national income in 1954 to 21% in 1964, to a peak of almost 40% in 1974 (Directorate-General of Budget, Accounting and Statistics 2015a: 41).

Radical scholars critical of the "developmental state" have not sought to contest the importance of state control or high levels of investment in Korean and Taiwanese industrialisation. There is not a direct disagreement with the developmental state paradigm on the content of policy. Rather, their critique of the statist approach focuses on three issues. First, Marxist scholars insist that we clearly distinguish between the state's autonomy from individual businesses and autonomy from the capital relation (Chang 2009). The autonomy of the state from the owners of capital is an empirical question. However, the modern state is an embodiment of broader capitalist social relations. The modern state only comes into existence with the separation of the moment of economic appropriation from direct coercion. This separation is only possible with the development of a capitalist economy where formally free labour meets capital in the marketplace



Second, the concept of “national developmental” is critiqued. The idea of “national” development is seen to imply a collective interest that, at some level, stands above class (Chang 2009: 60-1). If we instead focus on the role of the state in promoting capital accumulation we draw attention more clearly to the class nature of the state. In addition, there is a need to understand growth not as national but as regional and global phenomena. Cumings (1984) argues that industrialisation in Korea and Taiwan must be seen as part of a reconstruction of a Japanese-dominated regional economy, with Korea and Taiwan becoming sites of relatively low-paid production for industries that could no longer operate profitably in Japan. This system was based on easy access to the US market, with the US supporting East Asian growth to strengthen anti-communist regimes in the region (Woo, 1991; Gills, 2000). A different but related argument understands authoritarian state-led development as a “semi-peripheral” state form. So, the emergence of the developmental state can only be explained with reference to the world system (Song, 2011). The logic of these arguments is that the developmental state must be seen as a temporally limited project. The external conditions that initially support its functioning will inevitably change. Gills (2000: 391-40) argues that the developmental state was undermined by US trade pressure and a growing perception by both capitalists and state managers that competitiveness depended on the internationalisation of domestic firms.

If the developmental state is essentially a semi-peripheral state form then in so far as the project succeeds, and the state moves towards the core, it undermines its own viability. If we define states by income level it is impossible to consider contemporary Korea or Taiwan as part of the semi-periphery (Babones, 2005). Using figures adjusted for purchasing power parity, to allow for the fact that both actively intervene to suppress the values of their currencies, Taiwan and Korea have per capita GDPs of

\$46,833 and \$36,612 respectively. On the same basis, the figure for the UK is \$41,499 (IMF, 2015). Although, Taiwan's export structure remains, in many respects, characteristic of a semi-periphery economy with reliance on contract manufacturing and low-wages remaining a critical sources of competitiveness (Bureau of Labour Statistics, 2013). Korea, despite a lower level of per capita GDP, has higher levels of manufacturing wages and has been more successful in developing global brand names with greater market power. The statistics regarding the overall level of output of both economies are pertinent to this paper's focus on investment levels. Since the publication of *Capital* in the 1860s radical political economists have been concerned with the tendency of developed capitalist economies to generate more capital than profitable investment opportunities (Burkett and Hart-Landsberg, 2003: 362-5). In this context, the concept of development is a relational one. By modern standards 19<sup>th</sup> century Britain was not a particularly productive economy but Marx (1990) was able to consider it as an example of advanced capitalism because of its relational position. In relatively underdeveloped economies where capital stock per worker is much lower the problems related to capital glut that dog more advanced capitalism do not exist. Given access to the world market and a disciplined (subjugated) labour force there is almost no limit to the rate of investment that can be sustained. Over time, however, if the state moves closer to the core the problem of limited investment opportunities emerge.

An understanding of the developmental state as being compromised by the achievement of "development" does not negate Gills' focus on bilateral US pressures or domestic perspectives on the need to globalise. However, it does suggest that the developmental state, and the investment-led growth model that underpinned it, could

not, in the long-term, have survived irrespective of trade pressures or policymakers' perceptions.

Finally, the radical literature offers an intensified focus on the position of labour, small farmers and women within the developmental state. Both the Korean and Taiwanese states are seen to have used their control of agricultural prices to promote the movement of workers away from agriculture in order to suppress wage growth in the non-agricultural economy (Hart-Landsberg, 1993; Gills, 1999; Minns, 2006). Chang (2009: 60-66) argues that the developmental state paradigm largely takes the subordination of labour to capital as a given. The real focus is on state-capital relations. The Marxist literature instead demands that we place capital-labour relations at the forefront of our analysis of the developmental state. Marxist scholars have been more consistent than their statist counterparts in highlighting how the suppression of the growth of consumption by labour and small farmers was key to achieving the phenomenal rates of investment that lay behind rapid growth (Hart-Landsberg, 1993; Minns, 2006; Chang, 2009).

We accept the radical critique of the developmental state paradigm. However, the most significant point for us is the areas of convergence between these approaches. The key Marxist and statist texts on late development both conceive of the developmental state project as involving a profound social/economic transformation and a massive state-led mobilisation of resources for investment in key strategic industries. Few scholars, statist or Marxist, would contest that the pursuit of very high rates of investment was, historically, a core characteristic of the Northeast Asian developmental state.

When we compare the literature on how the developmental state functioned historically with those arguments that stress the resilience of the Korean and

Taiwanese developmental state in the contemporary world we see both continuities and differences in how the developmental state is defined. The argument that Korea and Taiwan remain developmental state draws upon, in different vocabularies, the ideas of state capacity and embedded autonomy (Weiss, 2003; Wong, 2005; Chu, 2007;; Thurbon, 2016). Equally, there is a consistent focus on the role of the state in promoting the development of productive capacity in those sectors it defines as strategically important. However, there are significant differences in the scale of intervention associated with the contemporary and historical Korean and Taiwanese developmental state. Korea and Taiwan's commitment to investing a meaningful level of resources in promoting strategically important industries is taken as evidence of their continued developmentalism (Amsden and Chu, 2003; Wong, 2005; Kim, 2012 Thurbon, 2016). This is quite different from historical analysis of the Korean and Taiwanese developmental state that understands the entire political economy as being shaped by the state's commitment to maximising investment in strategic sectors. In effect we move from a understanding of the developmental state in which the effective mobilisation of capital in pursuit of industrial policy is *the* primary objective of the state to one in which it is simply an important objective.

This new understanding of the role of industrial/investment policy raises three sets of issues. First, in practice all major capitalist states have minimally effective bureaucracies, seek to support the development of new technology and offer concessionary finance to firms operating in selected industries (OECD, 2016a; 2016b). Whether or not a state is developmental becomes an impossibly subjective question. Second, if we employ stylised state types they are only useful if they identify the dominant characteristics of the state. If we understand any state that maintains a commitment to promoting the growth of strategic industries as

developmental then the usefulness of this concept is undermined. A state may pursue strategic industrial policy but an overall assessment of its policy orientation may lead us to conclude that is better defined as neo-liberal or social democratic. It only makes sense to define a state as developmental if the mobilisation of capital in pursuit of industrial policy is *the* primary objective of the state. Finally, such a broad definition of the developmental state tends to obscure the scale of changes that taken place in the Korean and Taiwanese political economies. Profound changes in the nature of the growth regime, the organisation of finance (the shift to household borrowing) and the significance of industrial policy come to be understood as adjustment within the developmental state model.

We would argue that a meaningful working definition of the developmental state must draw upon the key statist and Marxist accounts of late development in Northeast Asia. As we have argued, despite key ontological differences both schools see the maximisation of investment in selected industries as a central defining characteristic of the developmental state. The developmental state commitment to maximising rates of investment shaped every aspect of social, economic and political life. If we understand a commitment to maximising rates of investment in strategic industries as a core characteristic of the developmental state it is clear that contemporary Korea and Taiwan cannot be defined as developmental state. The structural conditions for the existence of a developmental state, understood in these terms, has been eroded by the transition from an environment of capital shortage to capital surplus as these economies have developed.

### **The neo-liberal state**

The task of defining neo-liberalism is not an easy one. Actually existing neo-liberalisms bear little resemblance to the visions of neo-liberal scholars. For Peck (2012, 7) the neo-liberal state is always in a state of flux because the “utopian vision of a free society and free economy is ultimately unrealizable.” Neo-liberalism is always a work in progress. Waves of deregulation create instabilities. The state then engages in selective re-regulation to address these instabilities. At the same time, neo-liberalism is always shaped by the political and economic histories of the spaces (state, region or urban settlement) to which it is applied (Peck, Theodore, and Brenner 2009).

While recognising the complexity of contemporary neo-liberalism if we are to employ this concept we must establish its core distinguishing features. An important reference point is the literature on depolitisation (Bonefeld 1993). Both the developmental and social democratic states engaged in forms of politicised development. In very different ways, these states sought to directly intervene in labour-capital relations. In line with its twin commitments to maintaining full employment and low inflation the social-democratic state sought to control pay increases through institutionalised corporatist bargaining. The developmental state sought to control labour through direct (often violent) repression of any attempt to organise (Chang 2009).

The neo-liberal state seeks to refrain from direct intervention in labour-capital relations and instead seeks to impose discipline through the market. The state commits itself to liberalising labour and product markets while maintaining the integrity of money, not accommodating inflationary wage settlements through monetary policy (Bonefeld 1993). In this environment, the threat of unemployment serves to discipline labour and the threat of bankruptcy forces capital to effectively

control labour. Perhaps the clearest break in a regime of labour control can be seen in the UK where the 1974-1979 Labour government's policy of seeking to control inflation through a series of social contracts was replaced by the Thatcher Conservative government's turn to monetarism and a more than doubling of the rate of unemployment (Bonefeld 1993: 137-249). The control of labour through the abstract disciplines of the market and money has been buttressed throughout the core capitalist world by increasing Central Bank autonomy and the growth of contingent forms of employment (Harvey 1990; Jayasuriya 2001). For Korea, Chang (2009) argues that as there has been a drawback from the extreme forms of coercion associated with the developmental state an increasingly casualised workforce has been subject to an intensification of market disciplines.

While scholars such as Bonefeld and Chang, working within an open Marxist tradition, have focused primarily on state-capital relations the concept of depoliticisation can be extended to other areas. In the case of the developmental state the allocation of credit (capital) and thus intra-capitalist relations were clearly politicised (Jayasuriya 2001). This is also true, to a lesser extent, of the major advanced capitalist states in the post-war period. Until the 1970s, the British state used quantitative limits on specific categories of loans to encourage investment in manufacturing industry (Hodgman 1972). The state had concrete goals (for example, the maintenance of a particular economic structure) and intervened in the credit market to achieve them. The neo-liberal state, on the other hand, confines itself to creating regulatory frameworks and allows the market to determine the allocation of finance (Jayasuriya 2001). Importantly, regulatory frameworks should not seek to preserve or create particular market structures but rather allow competition to determine outcomes. Neo-liberalism ought not be reduced to depoliticisation.

However, depoliticisation lies at the core of the entire neo-liberal project and a focus on depoliticisation is useful in helping us understand processes of financial reform and labour market restructuring in Taiwan and Korea.

We must remain conscious of Peck's arguments regarding the incomplete nature of neo-liberal projects. When we define a state as neo-liberal we are making a judgement about its primary characteristics, not seeking to deny complexities or contradictions. Every major state employs some form of loan guarantee programme for small and medium enterprises (SMEs) and direct support for business research and development (R&D). While significant support for business R&D in most OECD states is less than 0.3% of GDP (OECD 2015a, 59). The median level of government loan guarantees across the OECD was only 0.18% of GDP in 2014 (OECD 2016a: 74). There is no pure neo-liberal state. The question becomes one of scale. States such as the UK, Australia and the US conform reasonably well to the neo-liberal model set out above in which both capital-labour relations and the allocation of credit are marketised/depoliticised.

The concept of the post-developmental state can provide a useful prism through which to consider how neo-liberal reform has interacted with and been shaped by the political and economic legacies of the developmental state in Taiwan and Korea.

### **The post-developmental state**

The literature on the post-developmental state is more limited than the literature on the developmental or neo-liberal state. Our analysis of Korea and Taiwan suggests that there are certain core features that former developmental state share that sets



them apart from states with different politico-economic histories. For this reason, we would argue that there is merit in employing and seeking to further refine the concept of the post-development state. At present the concept of the post-developmental state is employed in radically different, and incommensurate, ways across the literature on contemporary East Asia.

In certain texts, the post-developmental state is understood as a modernised developmental state that has adapted to a changing global environment through selective liberalisation but which retains its core commitment to strategic industrial policy (Weiss and Thurbon 2006; Uttam 2014). There is also a larger more complex and variegated literature that uses the concept of the post-developmental state to explore how neo-liberal reform interacts with the legacies of the developmental state to create hybrid forms of economic and social governance (Ong 2006; Doucette 2010; Chang 2012). This literature argues that within a post-developmental state we may expect to find a certain level of policy incoherence. In part, this may reflect the co-existence of radical neo-liberal reform in certain policy areas with limited change in others. At the same time, the institutions of the developmental state may survive but come to play a role antithetical to that project- for example state owned banks in Taiwan supporting the growth of consumer borrowing.

Our approach to understanding the post developmental state fits broadly within this latter school which stresses its hybridity and incoherence. However, we need to be careful when we discuss hybridity in Taiwan and Korea. The allocation of capital and capital-labour relations have been largely marketised in both, meaning that the essential elements of the neo-liberal project are in place. The developmental state is dead. The use of the term “post-developmental state” is not meant to suggest that Taiwan and Korea represent some sort of half-way house between developmentalism

and neo-liberalism. Rather, we employ the term to explore the form that neo-liberalism takes in a post-developmental context. The post-developmental state maintains a greater commitment to industrial and credit activism than other neo-liberal states. However, industrial policy now takes the form of significant but selective interventions within a marketised/ depoliticised economy. The logics of neo-liberalism are dominant.

Chang (2012) and Doucette (2010) argue that the most significant legacies of the developmental state relate to social policy. For these scholars, in former developmental state, the primary duty of the government is still understood as being to promote high rates of growth and to create an environment where individuals can enrich themselves through market exchange. The role of public welfare systems in meeting the material needs of citizens remains limited. For both Chang and Doucette the post-developmental state combines many of the worst features of neo-liberalism and developmentalism. Workers must compete within flexible deregulated labour markets without the benefit of adequate social safety nets. For Chang in particular this has led to a social crisis with large increases in rates of suicide and social withdrawal. We agree with this analysis and take it as a point of departure. As indicated in the introduction, we also seek to highlight the macroeconomic issues that the weakness of organised labour and low levels of welfare spending cause in both Taiwan and Korea. Put simply, by restricting the growth of working class incomes the underdevelopment of both welfare systems and the union movement heightens these states' dependence on consumer debt and current account surpluses as sources of demand.

We return to the question of welfare in the final section of the article. We now turn to changes in the organisation of finance, state-capital relations and the nature of the growth regime in Taiwan since the 1980s.

## **TAIWAN: A FLEXIBLE AND RESILIENT DEVELOPMENTAL STATE?**

Taiwan is frequently presented as the most important example of a developmental state that has successfully adapted to the demands of economic maturity and global economic change. The state is seen to have limited and controlled the process of financial liberalisation (Zhang 2002; Weiss 2003; Chu 2013). In so doing, it minimised the potential for instability and ensured that the financial sector remained subordinate to the industrial economy. Thurbon (2001: 253-59) argues that the financial system is still understood as a support for industrial development. While the precise content of industrial policy has changed, for many scholars, there is continuity in terms of the state's commitment to promoting the development of strategically important industries (Amsden and Chu 2003; Wong 2005; Weiss and Thurbon 2006). This reading of the process of financial reform and the continued significance of industrial policy can be questioned. Furthermore, there are a series of issues relating to the nature of the growth regime, the economy's dependence on excessive current account surpluses, cross-straits relations and wage stagnation that this literature essentially ignores.

At the same time, at least superficially, the argument that the state continues to play a critical role in mobilising and allocating investment appears viable. Eight of the ten largest commercial banks in Taiwan, accounting for over 40% of total deposits, remain under government control (Hu 2011, 9).

This reading of the process of financial reform is undermined when we focus on the growing significance of consumer borrowing. By 2013 the stock of loans extended to households exceeded loans to the non-financial corporate sector by 47%

(Bank of China 2015). Household debt in Taiwan increased from 76% of GDP in 2002 to 83% in 2014 (Fang 2011, 569; Bank of China 2015, 46). Taiwanese household debt is higher, in relative terms, than US debt. According to the Central Bank, household borrowing is growing much more rapidly than levels of debt in broadly comparable economies (Bank of China 2015, 46). As the 2008 global crisis demonstrated this scale of household debt does not simply constitute a problem for individual households struggling with debt but threatens the stability of the entire economy. The initial trigger for the 2008 crisis was a loss of confidence in the capacity of US households to service much lower levels of debt, in relative terms, than burden both Taiwanese and Korean household (Mian and Sufi 2011).

The importance of the shift from industrial to household finance cannot be overstated. The major commercial banks who have historically played a key role in supporting industrial investment are now primarily engaged in lending to households. This can partially be explained through the growing importance of equity and bond financing. However, the changing role of the Taiwanese banking sector is primarily a reflection of the overall shift in the demand for funds from the corporate to the household sector. The shift to consumer finance undermines the argument that changes in the financial system have been limited and that the basic structures of the Taiwanese developmental state remain in place. In many ways, the contemporary financial system represents the very antithesis of the developmental state system. Vast sums of money are channelled into supporting asset price inflation (increasing real estate prices) and consumption. Most borrowing has no clear link to the creation of new productive capacity.

The Taiwanese financial system is neither unambiguously developmental nor neo-liberal but contains elements of both systems. On the one hand, finance is

increasingly allocated according to price signals. Institutions lend to where they can achieve the highest-level of risk-adjusted return. On the other hand, a set of state-owned institutions remain at its core - albeit a set of institutions whose own behaviour is governed by price signals.

As we might expect, industrial policy has evolved alongside financial policy. Until the second half of the 1980s the state could prioritise the development of particular industries through its control over the credit system, the use of state-owned firms and heavy tariff protection. As economic liberalisation and the demands of global trade regulation made these policies impossible the state is seen, by its supporters, to have come to rely on subtler but no less effective forms of intervention (Amsden and Chu 2003; Wong 2005; Weiss and Thurbon 2006). For these scholars, there is policy change but a basic continuity of objectives. Using public research laboratories, the provision of infrastructure such as science parks, subsidies for private research, tax incentives and concessionary finance, the state is understood as being able to promote the development of effective collaborative research networks in strategically important industries (Amsden and Chu 2003: 77-118).

It is the scale of intervention that is critical in assessing the extent to which Taiwan remains a developmental state. If a commitment to industrial policy is a core characteristic of the contemporary Taiwanese state then we need to demonstrate that the state prioritises this policy in its use of resources. At 0.7% of GDP, public spending on supporting R&D is only marginally above the OECD average of 0.67% (OECD 2016b). The levels of funding attached to concessionary finance schemes to encourage the development of particular sectors are also relatively limited. The six flagship industries scheme, the state's core contemporary industrial promotion programme, involves spending approximately 1.4% of GDP over a five-year period

(Wang and Lin 2011, 100). OECD states spent a median 0.18% of GDP on concessionary finance schemes in 2014. One issue that limits the potential effectiveness of concessionary finance schemes is that Taiwan's most successful firms are large-scale net savers with no need for external finance (Directorate-General of Budget, Accounting and Statistics 2015a, 29).

Because of its history as a developmental state Taiwan maintains a greater commitment to industrial activism than most other advanced capitalist states. Spending on industrial promotion and supporting R&D is higher than the OECD average. However, these are differences of emphasis rather than fundamental principles. Levels of support may be higher in Taiwan but they are not of a different order of magnitude. In contemporary Taiwan, the allocation of capital is essentially determined by price signals rather than official interventions, total public spending on concessionary finance programs and supporting R&D is only marginally above 1% of GDP (Directorate-General of Budget, Accounting and Statistics 2015a, 29).

Analysis of the evolution of the Taiwanese political economy has largely ignored the fundamental changes that have taken place in the nature of the growth regime. However, changes in rates of investment have played a critical role in shaping the restructuring of the financial system, state-capital relations and destabilising the Taiwanese economy. Rates of investment have fallen fairly consistently since the early 1980s. Investment rates in Taiwan were at their highest from the mid-1970s to the early 1980s (Directorate-General of Budget, Accounting and Statistics 2015a, 41). Between 1974 and 1981 investment averaged 32.4% of gross national income. After 1981 rates of investment fell dramatically. Between 1982 and 1988 investment averaged 24% of gross national income. While rates of investment stabilised in the 1990s, investment has been consistently low since 2001. Gross investment averaged

22.4% of national income between 2001 and 2012. Corporate saving has exceeded net corporate fixed capital formation every year since 2006 (Directorate-General of Budget, Accounting and Statistics 2015a, 29; 39). This remains the case even if we consider net foreign direct investment, which averaged 0.8% of GDP between 1996 and 2012.<sup>1</sup> Furthermore, total corporate saving has exceeded NT\$1 trillion every year since 2009 – corporate saving had never previously exceeded \$1 trillion in consecutive years (Directorate-General of Budget, Accounting and Statistics 2015a, 29). Major Taiwanese firms are holding vast cash reserves. The fall in rates of investment can only be explained in terms of a lack of opportunity for profitable investments rather than a lack of finance. Many firms are in a position to increase investment without accessing external funding. It is illogical for a profit-maximising firm to simply hoard money if relatively safe opportunities for investment exist.

The investment-led growth model that lay at the heart of the developmental state project is not only dead but the body has been cold for some time. With it has gone the state's capacity to use access to finance as a tool through which to steer the economy and discipline capital. Equally, the shift away from investment-led growth made some form of financial liberalisation and move towards consumer borrowing inevitable.

As an economy moves from the semi-periphery to the core it is inevitable/desirable that opportunities for productive investment will decline and that there will be a shift towards consumption. However, in Taiwan the decline in investment has taken place in an environment where capital has increased its share of national output and where wages have been stagnant. Labour's share of national income fell steadily from 54.6% in 1995 to 47.8% in 2011 (Federal Reserve 2015). Real wages have been stagnant since the mid-1990s and were lower in 2012 than they

had been in 2000 (*Financial Times*, March 31, 2013; Lim 2014). Inequality has been steadily rising since the early 1980s (Zheng 2013). The conditions are not in place for a transition to a growth model based on steadily increasing domestic consumption supported by consistently rising wages.

The macro-economic impact of wage stagnation has, at least partially, been offset by a fall in levels of household saving. Between 1993 and 2013 the savings rate of households declined from 30.74% to 21.08%. We must go back to the mid-1970s to find lower overall rates of household saving than we see today (Republic of China 2015). Furthermore, there is a bi-fracturing of the household sector. Since 2001 the savings rate for the poorest 20% of households has, for the first time, been negative - in 2014 the poorest 20% of households' consumption equalled 107% of their disposable income (Republic of China 2015). The financial position of poorer Taiwanese households is precarious. There are clear limits to the extent to which the impact of future wage stagnation on consumption can be offset by reductions in savings by the working class.

The primary mechanism that Taiwan has relied on to maintain growth in the face of declining rates of investment has been massive current external surpluses. The current account moved from negative to positive in the early 1980s.<sup>2</sup> Taiwan's trade surplus with the US increased from US\$171 million in 1975, to US\$2 billion in 1980 to over \$10 billion in 1985 (Grey 2011, 589). Clearly this was not sustainable. Tsai argues that state managers perceived this as a major problem from the mid-1980s onwards. According to Tsai (2001, 365) "the really urgent problem (for state managers) was an emerging 'disequilibrium of the macro-economy'—insufficient domestic demand, excessive savings, an enormous trade surplus." Rising exports always played an important role in the developmental state. However, until the mid-



1980s the growth of exports had essentially been matched by the growth of imports. The issue that Taiwan faced in the mid-1980s was that the rapid growth of exports was no longer being mirrored by similar increases in imports. Taiwan was becoming increasingly dependent not simply on trade but a capacity to run chronic current account surpluses. Unsurprisingly, Taiwan came under intense pressure from the US to reduce its trade surplus.

Partly because of liberalisation and forced currency appreciation in response to US pressure the current account surplus fell sharply after 1988. The macro-economic effect of which was initially offset by massive fiscal expansion. Public spending increased from 23.1% of national income in 1987 to 35.8% in 1992 (Tsai 2001, 368). Since 2001 Taiwan has once again run consistently large current account surpluses. Between 2001 and 2014 Taiwan's current account surplus averaged 8.4% of GDP, over the same period Taiwanese growth averaged 3.9% (IMF 2015). Despite increases in consumer debt Taiwan is critically dependent on large external surpluses to avoid crisis. Taiwan's current accounts surpluses are now the product of trade with mainland China rather than the US. In 2014 exports, including re-exports, to China/Hong Kong came to \$127 billion. Imports from China/Hong Kong only came to \$49.7 billion. Taiwan's entire \$65 billion (12.3% of GDP) trade surplus in 2014 can be accounted for by trade with China/Hong Kong.<sup>3</sup>

Dependence on the mainland Chinese market is, on one level, more sustainable than the reliance on the US market. Taiwan has not faced the same political pressures from China to reduce its bilateral current account surplus. However, China's relaxed attitude reflects the potential of this surplus, and the dependence it represents, to undermine Taiwan's status as a *de facto* independent state (Grey 2011). The issues caused by Taiwan's over-dependence on the Chinese market

are fully understood by policymakers (*The Guardian*, May 20, 2016). Taiwan's inability to limit dependence on China must be related to its failure to increase domestic demand. It may have been desirable for Taiwan to move towards a somewhat more auto-centric economic model following its loss of concessionary access to the US market in mid-1980s. However the slow growth of domestic demand make a focus on constantly increasing exports unavoidable. Equally, the weak growth of domestic demand and the hyper-competitiveness of Taiwanese exports, supported by relatively low wages, make Taiwan an unattractive partner for free trade agreements with other states (Chiang and Gerbier 2013: 21). Given the weakness of domestic demand Taiwan needs unbalanced trade relations – in which exports massively exceed imports. Any trade agreements that operate on these terms are always likely to be difficult to establish and face political pressures within the deficit states. Taiwan's lack of size perhaps makes a high degree of dependence on trade unavoidable. However, it is the weakness of internal demand that lies behind Taiwan's dependence on current account surpluses and the problems that accompany this.

The evolution of the Taiwanese and Korean economies since the 1980s has, in many respects, been very different. Nevertheless, the processes of economic reform in both states have been conditioned by the crises in established investment-led growth models. The central problems that both economies face, over-dependence on current account surpluses and consumer debt, are the products of their failure to develop a sustainable alternative growth model. Although the scale and form in which they face these issues is far from identical, there are a core set of commonalities. It is to the crisis of the Korean developmental state we now turn.

## **THE CRISIS OF THE KOREAN DEVELOPMENTAL STATE**

Partially because of the 1997 economic crisis Korea is understood to have managed the process of economic liberalisation in a less judicious manner than Taiwan (see Zhang 2002; Wang 2007). Korea allowed a large and lightly regulated non-bank financial sector to develop and to have adopted an overly liberal attitude towards short-term overseas borrowing from the mid-1990s onwards. Equally significantly, the Korean state largely abandoned any attempt to co-ordinate private investment after 1993 (Chang, Park and Yoo, 1998). Scholars who maintain that contemporary Korea should be understood as a developmental state have argued that the state reasserted a commitment to strategic management of the economy after the 1997 crisis (Lee and Han 2006; Weiss and Thurbon 2006). In a sense Korea is less a resilient than a phoenix developmental state. This reading of a Korea that remains a developmental state, is undermined by an analysis of changes in the growth regime and the basic function of the financial system.

In contrast to Taiwan, levels of investment in Korea increased throughout the 1980s and early 1990s. Between 1976 and 1980 investment averaged 31% of GDP. According to the IMF levels of investment averaged 32.4% of GDP between 1981 and 1985, 35.4% between 1986 and 1990, and 39% between 1991 and 1996 (IMF 2015). On one level, therefore, the investment-led growth model in Korea appeared to be vibrant prior to the 1997 crisis. However, Korea was only able to achieve these rates of investment by partially suspending the requirement that investment be profitable. Between 1970 and 1987 the rate of profit remained at double-digit levels and there was no clear overall direction of movement. In 1987 the rate of profit was over 13%. After, 1987 the rate of profit fell consistently. In 1996 the rate stood at

6.1%. The underlying cause of falling profitability was a rise in the capital-output ratio (Jeong 2007, 58-60). This problem was compounded by the partial breakdown in systems of labour control after 1986 that allowed labour to increase its share of total output (Jeong 2007, 40). Woo-Cumings (2001: 357) sums the situation up well when she says, “by 1996 Korea was sustaining one of the lowest profit rates and highest rates of investment in East Asia.” This was not sustainable.

On the eve of the 1997 crisis Korea was in a form of limbo. On the one hand, the growth regime was unsustainable and key aspects of the developmental state governance model had been swept away. On the other hand, progress in developing a neo-liberal regulatory model had been practically non-existent (OECD 1999).

Since the crisis, major changes have taken place in systems of regulation and the nature of the growth regime. There has been an attempt to bring systems of financial regulation into line with standards set by the relevant international regulatory authorities (OECD 1999, 107-38). Meanwhile, the state actively promoted the sale of major domestic financial institutions to foreign investors. Through financial re-regulation and the expansion of foreign ownership the state has sought to construct a set of financial institutions that would discipline non-financial firms and force them to improve profitability.

The most significant changes to the financial system, from the perspective of this article, relate to the flow of funds and increasing foreign ownership of financial institutions. The financial system is increasingly orientated towards household rather than corporate borrowing. The share of total loans going to the household sector increased from less than 25% in 1996 to over 50% in 2006 (Chung 2009, 86). Since 2006 the growth in household borrowing has consistently outpaced corporate borrowing. According to the Bank of Korea, between 2011 and 2014 the growth in

lending to households by all financial institutions exceeded the growth in corporate lending by 59% (Bank of Korea 2012, 45; 2015, 43). At the same time, bond and equity financing has remained limited. The fall in corporate borrowing from financial institutions does not reflect financial disintermediation but a sharp decrease in the use of external finance by Korean firms.

Since the 1997 crisis Korean firms have improved their profitability moderately and dramatically reduced their levels of investment. Between 1998 and 2014 levels of investment averaged 31.2% of GDP. If we exclude 1998, to discount for the effect of the Asian crisis, this figure rises to 31.5% (IMF 2015). These figures represent a return to rates of investment last seen in the second half of the 1970s. Throughout modern Korean history investment has played an increasing role in the economy. Between 1965 and 1970 investment averaged 21.6% of GDP. Between 1970 and 1975 the same figure stood at 25.4%. A 31% investment rate in the latter half of the 1970s represented a marked increase on what had gone before and the maximum level of investment the economy was capable of sustaining. The macro-economic consequences of a 31% rate of investment are completely different when this rate represents a marked decline on what preceded it and where the resources clearly exist, as evidenced by levels of corporate saving, to sustain a higher rate.

Scholars critical of the impact of post-crisis neo-liberal reform have argued that the decline in levels of investment is a consequence of this reform (Shin and Chang, 2003: 83-129). However, this does not explain why corporate saving in Korea is much higher than in other economies where “shareholder capitalism/ neo-liberalism” is far more embedded and other behaviours associated with this model (share buy backs and dividends) are more prevalent. Korean firms hold cash reserves equivalent to 33% of GDP. To put this figure in context, American firms hold

reserves equivalent to 11% of GDP (*The Economist*, September 27, 2014). The fall in levels of investment in post-crisis Korea reflects the limited availability of relatively safe profitable investment opportunities. The long-term decline in the output-capital ratio, outlined above, is indicative of a fall in the level of opportunities for profitable investment. Pre-crisis rates of investment were artificially inflated by suspending any rigorous assessment of the likely profitability of investment. Post-1997 reforms have forced firms and financial institutions to seriously assess the profitability of prospective investment. The decision of leading firms to hold extraordinary levels of liquid financial assets that offer low returns can only be explained by a lack of opportunities for more profitable investment. There are real limits to the capacity of a relatively mature capitalist economy, such as Korea, to generate opportunities for investment.

These constraints have been compounded by the way capital has sought to improve profitability since the 1997 crisis. The output-capital ratio has improved marginally since the crisis as firms have invested more selectively (Jeong 2007, 60). However, the overwhelming source of improved profitability has been capital's capacity to increase its share of total output at the expense of labour. Between 1996 and 2012 labour's share of output fell 13.6%.<sup>4</sup> On one level, this is clearly functional from the perspective of capital. However, by successfully suppressing wage growth Korean firms impaired the prospects of any transition to a consumption-led growth model focused on the domestic market.

Given the decline in the rate of investment and the slow growth of wages we may have expected the economy to experience very low growth after 1997. However, between 1998 and 2014 growth averaged 4.2% per annum (IMF 2015). While modest by historical standards, this represented one of the highest growth rates in the OECD

area. Critical to this achievement has been the collapse in household saving and the maintenance of sizeable current account surpluses.

Net household saving fell from 16.4% of disposable income in 1996 to a low of 1.1% in 2002.<sup>5</sup> Since this point savings have recovered slightly, averaging 5.2% between 2002 and 2014. To put these figures in context, between 1986 and 1996 saving averaged 22.5%. The collapse in net saving has, predictably, been mirrored by increases in household debt, which increased from 80% of net disposable income in 1996 to 161% in 2014 (OECD 2015b). Saving rates for affluent Koreans have remained at pre-crisis levels, with the wealthiest 20% of households consistently saving between 35% and 45% of their disposable income between 1992 and 2005. Savings rates for the poorest 20% of households fell dramatically after the crisis. Prior to the crisis savings rates for the poorest 20% of households had been low but positive. By 2004 the savings rate for these households was -17% (Chung 2009, 88-89). While overall levels of saving have increased in recent years poorer Koreans continue to accumulate debt. The annual consumption of the poorest 20% of households exceeded disposable income by an average of 13.5% between 2010 and 2014.<sup>6</sup> Low income Koreans have responded to wage stagnation by using credit as a substitute for non-existent wage increases. The collapse in savings and the growth in borrowing among low and middle-income households has allowed for consumption to grow more rapidly than wages since the 1997 crisis.

Since 1997 Korea has become increasingly dependent on external demand and its capacity to run permanent current account surpluses. Trade has played a significant role in the development of the economy since the 1960s. Nevertheless, historically trade played a different role in the Korean developmental state project to the Taiwanese, partially because of the different sizes of these states. Korea's export to

GDP ratio in 1996 was 25.7% while Taiwan's was over 45%. Since the 1997 crisis Korea has developed the same intense dependence on exports as Taiwan. By 2014 the export to GDP ratio stood at 50.6% (World Bank 2015). Between 1998 and 2014 Korea ran an average annual current account surplus of 3.1% of GDP (IMF 2015). Throughout this period Korea's bilateral trade surpluses with China/Hong Kong have dwarfed those achieved with any other state. Between 1998 and 2014 Korea ran a cumulative trade surplus with China/Hong Kong of \$721 billion.<sup>7</sup> Increasing economic integration with China does not pose the same political threat to Korea as Taiwan. However, Korea's over-dependence on export growth and permanent current account surpluses leaves it highly vulnerable to any form of regional or global turbulence; Korea's recovery from the global economic crisis was, at least in part, driven by its capacity to increase exports to China/Hong Kong by over \$35 billion between 2009 and 2010. Were China to experience a major economic crisis it is difficult to see how Korea could avoid a recession. Korean policymakers have been open about the economies excessive reliance on current account surplus/exports but have unable to effectively address the issue (Ministry of Finance 2014).

Korea's dependence on current account surpluses is not as severe as Taiwan's. The Korean economy has, however, been more dependent on the collapse of domestic saving to maintain growth than Taiwan. Taiwan and Korea face many of the same issues, stemming from the collapse of investment-led growth regimes. Although levels of investment are very different in the two economies, in both cases investment has been falling consistently and has lost its capacity to drive economic growth. This new environment, where the essential problem is one of capital surplus rather than shortage, has led to a fundamental reorientation of the financial system from corporate to consumer borrowing. It follows from the arguments set out above, regarding the



organisation of finance and the nature of the growth model that Korea, like Taiwan, can no longer usefully be categorised as a developmental state. Having said this, the legacies of the developmental state continue to shape certain aspects of policy.

The government continues to manage the development of certain key domestic markets, most notably telecommunications, to support product innovation by key manufacturers (Y Kim, 2010). The state's role in promoting collaborative research and managing "competition" goes far beyond that we may expect a "normal" neo-liberal state to play. Korea spends appropriately 1% of GDP on public support for R&D, the second highest level in the OECD area (OECD 2016b).

Korea's history as a development state is also reflected in contemporary systems of industrial finance. In 2013, 9% of all business loans and 12.2% of loans to SMEs carried some form of official guarantee. Japan is the only other state in the OECD area that makes use of credit guarantees and official financing on a similar scale (OECD 2015c, 255). Thurbon (2016: 125-43) takes the extensive use of official credit guarantees in contemporary Korea as evidence of the health of the developmental state. However, the logics underpinning the contemporary Korean state's interventions in the credit market are very different from those that informed the allocation of credit by the developmental state. Credit guarantees are not extended to the most dynamic firms. Rather, they are used to support employment within SMEs engaged in low value-added activities with limited growth potential and chronic profitability problems (OECD 2014). Contemporary interventions in the credit market can be a means of managing the problems that the developmental state and subsequent processes of neo-liberal reform have created. The uneven relationships between SMEs and large firms, which contributes significantly to the weakness of the SME sector, can, at least partially, be attributed to the Korean developmental state's

privileging of the *chaebol* (Woo-Cumings 1991; Hart-Landsberg 1993; Lee 1997; Minns 2006). Equally, the turn to consumer finance associated with financial liberalisation has compounded the difficulties that SMEs face in accessing credit.

In both Korea and Taiwan, we see neo-liberal reform interacting with the institutional and policy legacies of the developmental state in complex and often contradictory ways. In Taiwan, we see state-owned banks turn away from industrial towards consumer financing. In Korea, we have seen a similar shift towards consumer finance and a retreat from comprehensive industrial policy. At the same time, the state continues to play a much greater role in the allocation of credit and actively managing the development of selected industries than in other OECD members. In both Korea and Taiwan contemporary systems of governance reflect the impact of substantial neo-liberal reform and the importance of path-dependency. Korea and Taiwan have faced similar issues relating to overdependence on exports, excessive corporate saving and sharp rises in consumer debt. The existence of a common set of issues across the two states points to the utility of employing the concept of the post-developmental state to explore the problems associated with neo-liberal transition in former developmental state. Whether we see the legacies of the developmental state in the spheres of industrial and financial policy as malign or benign is somewhat subjective. The legacies of the developmental state in terms of social policy and capital-labour relations are more clearly problematic. It is to these issues we now turn.

## **LABOUR, SOCIAL WELFARE, OVERACCUMULATION AND THE POST-DEVELOPMENTAL STATE**

Valuable work has been conducted on the social and political impact of neo-liberal market reform in a post-developmental context where the welfare state is underdeveloped (see, for example, Lim and Jang, 2006; Song, 2009). These scholars focus on the obstacles that the political and ideational legacies of the developmental state create for the development of an effective social-democratic politics that seeks to confront the underdevelopment of welfare systems (Doucette, 2010; Chang, 2012). The legacies of the developmental state are seen to interact with neo-liberalism in a socially pathological manner. We may build upon this literature in two ways. First, while making important political and intellectual points, the literature is often limited in terms of its use of concrete data in relation to wages, temporary employment, social spending and so on. We seek to ground these arguments empirically. Second, we highlight the macro-economic impact of the underdevelopment of welfare structures and the weakness of the labour movement.

From the perspective of Korean and Taiwanese capital the decline in labour's share of national income is a paradoxical phenomenon. On the one hand, the slow or non-growth of wages has supported international competitiveness and propped up profits. On the other hand, in an economy with limited profitable investment opportunities an increase in the proportion of output captured in the form of profits will, all other things being equal, reduce effective demand. This is particularly true where the leading firms hoard cash. Furthermore, in so far as firms use additional profits to increase dividends this will disproportionately benefit the richest households with the lowest propensity to consume. High levels of wage inequality will limit demand for the same reason. A transition to a consumption-led growth model, which is not based on an unsustainable accumulation of consumer debt, requires strong broad-based wage growth.

As regulation theorists convincingly argue, echoing Marx's own analysis of crises of realisation, excessive high and low wages both have capacity to undermine the stability of national capitalisms (Boyer, Uemura and Isogai 2012). Capitalist state managers in Korea and Taiwan acknowledge that their economies are over-dependent on consumer debt and external demand. The benefits of low wage growth to Korean and Taiwanese capitalism are outweighed by the costs. In the long-term, these economies are likely to be more stable if the growth regime was based on steadily increasing domestic wages. While this may make these economies somewhat less competitive internationally it would simultaneously make them less dependent on exports. Economic stability is not optimised by maximising international competitiveness. While a lack of competitiveness, and the attendant issues with current account deficits, can destabilise so can hyper-competitiveness based on suppressing domestic demand.

The underdevelopment of welfare systems in Korea and Taiwan exasperates the impact of low wage growth on domestic demand. A comprehensive welfare system, funded by progressive taxation, effectively transfers income from actors with a lower propensity to consume (major firms and wealthy households) to households with a high propensity to consume (the relatively poor).

It follows from what we argue above that as far as the legacies of the developmental state effect the capacity of labour to defend its material interests and the development of public welfare systems they have implications for macro-economic stability. Econometric analysis has highlighted the importance of trade union strength and the generosity of the welfare state in accounting for differential declines in labour's share of output across different national economies (Stockhammer, 2003). Low levels of independent union membership, the de-

legitimisation of social democratic parties and the underdevelopment of welfare systems in contemporary Korea and Taiwan reflect their histories as developmental states (Deyo, 1989; Hart-Landsberg, 1993; Waldner, 1999; Minns, 2006). It is impossible, therefore, to understand the inability of the Korean and Taiwanese working class to successfully defend their collective interests in the contemporary period without reference to the developmental state.

As discussed above, wages in Taiwan have been largely stagnant since the mid-1990s. The underlying causes of wage stagnation may lie in the shift in manufacturing to mainland China and deindustrialisation in Taiwan, the limits inherent in contract manufacturing, slower economic growth and the end of full employment (Chen 2014). At the same time, however, the dominance of “craft unions” which have been promoted by the state to administer pensions and health care insurance has left workers in a poor position to resist wage stagnation. Analysts of Taiwanese labour markets, both domestic and foreign, agree that craft unions cannot be defined as unions in the sense that the term is commonly understood (Wang and Cooney 2002). Membership of bona fide unions peaked at 700,000 in 1990 (about 8.3% of workforce) and has since declined. In 2014 only 624,148 employees or 5.4% of the workforce were members of non-craft unions (Directorate-General of Budget, Accounting and Statistics 2015b, 55). Levels of union membership in Taiwan are less than a third of the OECD average. The legacies of state repression of independent trade unions are reflected in the contemporary weakness of the Taiwanese labour movement (OECD 2015c). Furthermore, the lack of an electorally credible social democratic party, which reflects the historical exclusion of labour from the developmentalist coalition, limits the extent to which labour can seek protection through state regulation. Taiwan’s minimum wage did not rise between 1997 and

2006.<sup>8</sup> At the same time as being impacted upon by the legacies of politicised systems of labour control, the Taiwanese working class has had to cope with the end of full employment since the mid-1990s, and the strengthening of market (neo-liberal) discipline that accompanies this.

A similar set of arguments can be applied to the development of labour markets in Korea. In the post-1997 period labour has failed to prevent the erosion of its share of national income in the face of lower economic growth, deindustrialisation and a determined offensive by capital. An explanation of this failure must focus on the manner in which the legacies of the developmental state project have interacted with neo-liberal labour market restructuring.

The independent trade union movement has played a critical role in modern Korean history (Koo 2001). However, the proportion of total workers who were unionised peaked at 18.6% in 1989 – the OECD average at the time was 26.3%. Because of the construction and maintenance of an exclusionary growth oriented political coalition, organised labour in Korea was never able to achieve the policy leverage or the broad-based organisational strength that unions enjoyed in other states. By 2010 less than 10% of all workers were members of trade unions as opposed to an OECD average of 17.6% (OECD 2015c). Korean trade unions have experienced similar declines in membership to those in other states but from a lower initial starting point. The historical exclusion of labour from the developmental coalition is also reflected in the weakness of social democratic politics in contemporary Korea.

The weakness of trade unions and protective labour market regulation are common to both Korea and Taiwan. The particular set of policies the Korean developmental state pursued created additional problems of labour market bifurcation

through its bias towards large firms. Since the late 1980s workers in large firms have won significant concessions from capital. In 1980 workers in large firms, with over 500 employees, earned 7% more than their counterparts in small firms with under 29 employees (Koo 2001, 206). By 1997 this had increased to 28%. By 2013 the gap between wage levels in small and large firms had grown to 39% – the gap between workers in large firms and micro enterprises with fewer than 10 employees was 48% (Korean Labor Institute 2015). Wage differentials between large and small firms in Korea are much higher than in other states with a comparable level of per capita GDP. Furthermore, workers in the SME sector are frequently employed on a casual basis. According to official figures 21.6% of all workers were employed on a temporary basis in 2014 (OECD 2015e). It is worth highlighting that these figures are based on workers' own perception of their employment status. The proportion of workers without formal permanent contracts is much higher – between 35% and 55% (OECD 2004, 89). High levels of *de jure* temporary employment pre-date post 1997 neo-liberal restructuring. In 1997 Korea had the highest levels of *de jure* temporary employment in the OECD, with most sources estimating that over 40% of workers lacked permanent contracts (Pirie 2008, 184).

The decomposition of the working class into a core of relatively highly paid workers and a larger more precarious employed periphery is frequently seen as a characteristic of neo-liberalism (Harvey 1990). In Korea, however, labour market polarisation clearly pre-dated the neo-liberal turn. Labour market restructuring after the 1997 crisis compounded the problem of polarisation by further expanding the periphery. Restrictions on the ability of firms to lay off permanent workers were relaxed and there was a sharp rise in the levels of temporary employment (Lee 2002). The proportion of workers employed by large firms, with over 300 employees,

decreased from 30.7% in 1997 to 12.3% in 2012.<sup>9</sup> Decreasing employment in large firms was a result of the increasing use of sub-contracting by these firms to take advantage of the lower labour costs in the SME sector. An increasing proportion of the Korean workforce was directly subject to the disciplines of the market sworn from legal protections and the established compromises that labour and management had reached within profitable large firms.

Korea has the second highest proportion of workers earning less than 66.6% of median earnings of the 21 OECD states (OECD 2015f). Korea also has the fourth-highest level of temporary employment in the OECD (OECD 2015d). Labour market inequalities in Korea are deeply gendered. Korea has by far the largest gender pay gap in the OECD (OECD 2015g). Contemporary gender inequalities reflect the manner in which Korean women were incorporated into the developmental state project (Gills 1999).

Left-Keynesian economists have argued that the absence of a strong welfare state effects labour's capacity to defend its material position by intensifying the costs of unemployment and shaping the overall wage bargaining environment (Stockhammer, 2013). The lack of extensive welfare provision sharpens market disciplines. The legacies of the developmental state hostility to social spending is reflected in contemporary Korea and Taiwan. In 2014 net social spending by central government in Taiwan amounted to 3.6% of GDP.<sup>10</sup> In 2014 public welfare spending in Korea accounted for 10.4% of GDP. Social spending in Korea was less than half the OECD average. No other OECD state with a similar or higher per capita income spent less than 15.5% of GDP on public welfare (OECD 2015h).

The impact of neo-liberal reform is always conditioned by pre-existing economic and social structures. In states with social democratic traditions, the



negative social impact of neo-liberalism is ameliorated by these structures. In Korea and Taiwan, the impact of labour market deregulation, casualisation and the strengthening of market-based systems of labour control is exacerbated by the legacies of repressive, politicised systems of control associated with the developmental state.

## **CONCLUSION**

This article has sought to argue that declines in the rate of investment in Korea and Taiwan have been key to the wider restructuring of systems of economic governance. A focus on achieving and sustaining high rates of investment lay at the core of the developmental state project. However, in so far as the developmental state is successful, it undermines the conditions necessary for its continued functioning. Developed capitalist economies tend to generate more funds for investment (savings) than can be profitably employed by non-financial firms. Financial systems increasingly focus on consumer rather than industrial finance. The basic function of the financial system changes from facilitating investment to consumption. Furthermore, as firms increasingly come to finance investments through internal resources the state loses its capacity to discipline firms' behaviour through access to credit. To be sure aspects of the developmental state governance regime remain in place but in many cases they no longer function in a coherent manner. So state-owned banks in Taiwan primarily focus on consumer rather than corporate finance.

There are important similarities in terms of the structural changes that undermined the Korean and Taiwanese developmental state, the issues that both states have faced in adapting to the end of investment-led growth and how the legacies of

the developmental state continue to shape contemporary political economy. In particular, the repression of labour and the underdevelopment of welfare structures by the developmental state have contributed significantly to the problems that both states have faced in shifting to consumption-led growth. The overdependence of both economies on consumer debt and current account surpluses is a direct product of the inability of the domestic working class to defend their material interests. A resolution of these problems requires a shift in the balance of class forces.

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## NOTES

<sup>1</sup> Data available from the United Nations Conference on Trade and Development's database (<http://unctadstat.unctad.org/>).

<sup>2</sup> See Republic of China National Statistical Portal for details (<http://eng.stat.gov.tw/ct.asp?xItem=33339&ctNode=3570&mp=5>).

<sup>3</sup> Taiwan's bilateral trade statistics are available from the Bureau of Foreign Trade (<http://cus93.trade.gov.tw/ENGLISH/FSCE/>).

<sup>4</sup> Labour income share ratios are available from [www.stats.oecd.org](http://www.stats.oecd.org)

<sup>5</sup> All statistics for net aggregate household saving are taken from the OECD's statistics website (<http://stats.oecd.org>).

<sup>6</sup> See Household Income and Expenditure Trends (<http://www.kostat.go.kr/>) for more details.

<sup>7</sup> All bilateral trade statistics for Korea are taken from the Korean Custom Service's website (<http://www.customs.go.kr/>)

<sup>8</sup> Data available from the International Labour Organisation's database [http://www.ilo.org/ilostat/faces/help\\_home/data\\_by\\_country/country-details/indicator-details?country=TWN&subject=EAR&indicator=EAR\\_INEE\\_NOC\\_NB&datasetCode=YI&collectionCode=YI&\\_afLoop=304934363100773#%40%3Findicator%3DEAR\\_INEE\\_NOC\\_NB%26subject%3DEAR%26\\_afLoop%3D304934363100773%26datasetCode%3DYI%26collectionCode%3DYI%26country%3DTWN%26\\_adf.ctrl-state%3Dsrt3t6kd8\\_187](http://www.ilo.org/ilostat/faces/help_home/data_by_country/country-details/indicator-details?country=TWN&subject=EAR&indicator=EAR_INEE_NOC_NB&datasetCode=YI&collectionCode=YI&_afLoop=304934363100773#%40%3Findicator%3DEAR_INEE_NOC_NB%26subject%3DEAR%26_afLoop%3D304934363100773%26datasetCode%3DYI%26collectionCode%3DYI%26country%3DTWN%26_adf.ctrl-state%3Dsrt3t6kd8_187).

<sup>9</sup> See [http://www.smba.go.kr/eng/smes/statistics\\_01.do?mc=usr0001148](http://www.smba.go.kr/eng/smes/statistics_01.do?mc=usr0001148) for details.

<sup>10</sup> Data available from Directorate-General of Budget, Accounting and Statistics (<http://eng.dgbas.gov.tw/ct.asp?xItem=36243&CtNode=6103&mp=2>).

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